

## Choice of Chapter and Required Filings in Chapter 12<sup>1</sup>

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- I. **What's Different in Chapter 12:** When enacting Chapter 12, Congress sought to provide family farmers with a quicker and less expensive alternative to Chapter 11 in order enable family farmers to reorganize their debtors and keep their land, while providing fair treatment of creditors. Chapter 12 offers the best of both Chapter 11 and Chapter 13 to a family farmer.
  - a. **Co-Debtor Stay** --11 U.S.C. § 1201:
    - (a) “[A] creditor may not act, or commence or continue any civil action, to collect all or any part of a *consumer debt* of the debtor from any individual that is liable on such debt with the debtor, or that secured debt, unless—
      - (1) such individual became liable on or secured such debt in the ordinary course of such individual’s business; or
      - (2) the case is closed, dismissed, or converted to a case under chapter 7 of this title.”
  1. Courts have held that because sections 1201 and 1301 are nearly identical, the case law interpreting the co-debtor stay in Chapter 13 cases applies to Chapter 12 cases as well. ***See In re SFW, Inc.*, 83 B.R. 27, 30 (Bankr. S.D. Cal 1988)** (“The legislative intent that Chapter 13 case law control interpretation of Chapter 12 provisions which are nearly identical in substances is clear.”); ***In re Bigalk*, 75 B.R. 561, 565 (Bankr. D. Minn. 1987)** (“Section 1201 is a verbatim reenactment of 11 U.S.C. § 1301 in the Chapter 12 context. As a result, the legislative history of, and the caselaw development under, § 1301 are appropriately consulted in applying § 1201.”).
    - i. “Consumer debt” means “debt incurred by an individual primarily for a personal, family, or household purpose” (11 U.S.C. § 101(8)).
  2. Chapter 11 does not provide a co-debtor stay.
  3. **Practice Pointer**—If an entity and an individual are obligated on a non-consumer debt, both may need to file. If two individuals are obligated on a non-consumer debt, both may need to file. If two individuals are

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<sup>1</sup> Developed from material co-written with Judge Rebecca B. Connelly and used with permission.

obligated on a consumer debt, a Chapter 12 filing by one will provide protection in the form of the automatic stay to the other.

- b. **Cash Collateral and Adequate Protection** --11 U.S.C. §363 (c)(2)—“The [debtor-in-possession] may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless— (A) each entity that has an interest in such cash collateral consents; or (B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.”
1. These provisions apply to all Chapters, but tend to be an issue in Chapters 11 and 12, where a debtor needs to use its cash (e.g. money in the bank) or cash equivalents to continue to operate and another entity (e.g. a creditor) has a lien (e.g. an interest) on the cash.
  2. 11 U.S.C §363 (a)—defines cash collateral. Generally means cash, securities or other “cash equivalents”...“in which the estate and an entity other than the estate have an interest and includes the proceeds, products (*think* crops), offspring (*think* livestock), rents or profits of property...whether existing before or after the commencement of a case.”
  3. The debtor may use cash collateral only upon the conditions set forth in 11 U.S.C.S. § 363(c)(2), which requires either **consent** by the creditor to the use of its cash collateral, or a court **order** authorizing its use.
  4. Chapter 12 has its own separate treatment of adequate protection. 11 U.S.C. § 1205(a) specifically states that Section 361 does not apply in Chapter 12.
    - i. 11 U.S.C. §1205(b)-- the debtor may be required to provide adequate protection to a secured creditor in certain circumstances such as when a creditor requests relief from the automatic stay, when the debtor proposes to use, sell, or lease property, or when the debtor desires to borrow money or incur credit secured by a priming lien, **to the extent the use will result in a decrease in the value of the property securing the claim.**
    - ii. Under § 363(e), in all cases the debtor must provide adequate protection of the creditor's interest as a condition of using cash collateral. ***In Re Wilson***, 378 B.R. 862 (Bankr. D. Mont 2007) (citing ***Scottsdale Medical Pavilion v. Mutual Benefit Life Insurance Company in Rehabilitation***, 159 B.R. 295, 302 (9th BAP 1993))
    - iii. Adequate Protection can be provided in the form of an equity cushion. ***In Re Wilson***, 378 B.R. 862 (Bankr. D. Mont 2007)
    - iv. Debtor’s counsel must understand the different categories of collateral under the UCC to determine the extent and perfection of a creditor’s lien. In most Chapter 12 cases there will generally be a creditor with a lien on Farm Products, in addition to potentially a lien on accounts, equipment, etc. The UCC (Va. Code. Ann. §8.9A) sets for the requirements for obtaining and

perfecting liens on personal property (as opposed to real property). Farm Products are defined in Va. Code §8.9A-102 (34): "Farm products" means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are: (A) crops grown, growing, or to be grown, including: (i) crops produced on trees, vines, and bushes; and (ii) aquatic goods produced in aquacultural operations; (B) livestock, born or unborn, including aquatic goods produced in aquacultural operations; (C) supplies used or produced in a farming operation; or (D) products of crops or livestock in their unmanufactured states."

- i. A secured creditor's lien on "Farm Products" contemplates a crop "to be grown" sometimes in the future and a creditor's lien on "Farm Products" will attach to after acquired collateral. Therefore, consent of the creditor must be obtained or adequate protection provided prior to using proceeds from future crops. *In re Moore*, 465 B.R. 111 (Bankr. N.D. Miss 2011).

5. **Practice Pointer**—Cash collateral and adequate protection are not usually an issue in Chapter 13. Chapter 12 debtor's counsel should obtain a UCC Search and a real property Title Search prior to filing to determine the extent and perfection of any liens against the Debtor's real and/or personal property. Do not rely on the Debtor's understanding of the liens. Frequently almost all property used in connection with the farming operation will serve as collateral in addition to the proceeds of any crops and any offspring of any livestock. The perfection of the lien must be checked. If liens exist, and they usually will, negotiate the use of cash collateral with the creditor(s) pre-petition and prepare an Agreed Order for Use of Cash Collateral or prepare and file a Motion for Use of Cash Collateral with the Petition. Issues of cash collateral must be resolved early on so that the proceeds of livestock and crops can be utilized as part of the Debtor's plan.
- c. **The Role of the Trustee**— The duties of the Chapter 12 trustee are generally supervisory, like those in Chapter 13, unless the debtor in possession is removed at which point the trustee steps into the position of the debtor like a Chapter 11 trustee. The Chapter 12 Trustee will not operate or oversee the farming operation, but may require periodic reporting. In the WDVA there is no standing Chapter 12 Trustee, but in the experience of the author the current standing Chapter 13 Trustee will be assigned to serve as the Chapter 12 Trustee, as if it were a Chapter 13.
- d. **Post Petition Operations**— Generally, a "debtor shall remain in possession of all property of the estate." 11 U.S.C. §1207(b). Unlike Chapter 11, the term "debtor in possession" is not defined in Chapter 12.
- e. Unlike Chapter 11, in Chapter 12 there is:

1. No creditors committee
2. No requirement for a Disclosure Statement
3. No Voting
4. No Absolute Priority Rule
5. No provision for parties other than the debtor to file a Plan
6. No U.S. Trustee Fees

- f. **Attorney Fees**--There is no a “flat fee” or established “no look fee” for Chapter 12 cases in the WDVA. Each case will require its own fee structure. Counsel should be prepared to maintain time records even if charging a flat fee. In the experience of the author, the time involved in a successful Chapter 12 similar to the time involved in a small (but complicated) Chapter 11.
- g. **Chapter 12’s Super Provision:** Unlike Chapter 13 (and Chapter 11), in Chapter 12 a Debtor may modify debt that is secured solely by the debtor’s primary residence. This is a BIG advantage of Chapter 12 and often the reason to choose Chapter 12 over another Chapter. 11 U.S.C. §1222(b)(2).

## II. Required Filings

### a. Rule 1007

1. Schedules and Statements must be filed within 14 days of petition.
2. Debtors do not have to file a Statement of Intention.
3. A corporate debtor must file with its petition a list “containing the name and address of each entity included or to be included on Schedules D, E,F,G, and H”, as well as a Corporate Ownership Statement with the information required by Rule 7007.1. (Rule 1007(a))
4. The Debtor must file a plan within **90 days** of order for relief. (11 U.S.C. § 1221). This can be a significant advantage of Chapter 12.

### b. The Plan.

1. Timing—Plan must be filed within 90-days after filing Petition. Court may extend deadline if Debtor can show the “need for an extension is attributable to circumstances for which the debtor should not justly be held accountable.” 11 U.S.C. §1221.
2. Unlike Chapter 13 there is no “form” plan. Each case will require different plan provisions and structure depending on the facts and circumstances.
3. Required Plan Provisions—The plan “shall” (11 U.S.C. §1222(a)):
  - I. Provide for payments of fixed amount to the trustee on a regular basis;

- i. Not necessarily monthly, depends on nature of farming activities and cash flow, frequently quarterly, sometimes annually.
- II. Pay all disposable income to trustee over a 3 to 5 year period;
  - i. 11 U.S.C. §1225(b)(1)(C) requires at least 3 years. 11 U.S.C. §1222(c) limits a plan to 5 years.
  - ii. Payments to secured creditors can be paid for longer than 5 years outside the Plan.
  - iii. Disposable income is all income not needed to pay living expenses and expenses necessary for the continued operations of farm. 11 U.S.C. §1225(b).
- III. Provide for full payment of all priority claims (unless creditor agrees to a different treatment)
  - i. May pay less than full payment of domestic support obligations if paying all disposable income into the plan for 5 years (11 U.S.C. §1222(a)(4)).
- IV. Optional Plan Provisions—A plan “may” (11 U.S.C. §1222(b)).
  - i. Many of the same provisions as Chapter 13 (11 U.S.C. §1322(b))
  - ii. Modify the rights of holders of secured claims, or of holders of unsecured claims.
    - i. Including modification of the debtor’s residential mortgage!
- 4. Plan Confirmation--11 U.S.C. §1225 (a)
  - I. The court “shall” confirm a plan if:
  - II. Proposed in Good Faith;
  - III. Meets liquidation analysis;
  - IV. Secured creditors accept treatment OR provide to pay at least the present value of collateral securing claim OR surrender collateral;
  - V. Feasible; and
  - VI. All post-petition Domestic Supports Obligations have been paid
- 5. If Trustee or Unsecured Creditor objects to confirm then plan may not be approved unless (11 U.S.C. §1225 (b)(1)):
  - I. Plan pays unsecured claims in full;

- II. All disposable income is projected to be paid to the Trustee over a 3 to 5 year plan; or
  - III. Value of property to be distributed under the Plan is not less than the debtor's projected disposable income.
6. Valuation—Replacement Value is the appropriate measure of value. ***Associates Commercial Corp. v. Rash***, 520 U.S. 953 (1997).
- I. *Rash* standard has been adopted in Chapter 12 cases. ***See, In Re McElwee***, 449 B.R. 669 (Bankr. N.D. Pa. 2011).
7. Interest Rate—*Till* standard used in determining amount required to pay "present value."
8. Feasibility—Generally liberally construed, but more contested than in Chapter 13, due to the unpredictable nature of farming in general.
- I. Must show that payments can be made. Requires a thorough budget of projected income and expenses. This should be prepared prior to case filing if at all possible.
9. Confirmation—Hearing shall be concluded not later than 45 days after the filing of the plan.
- I. Valuation and Feasibility are generally the most contested issues at confirmation.

### III. Case Strategies: Practice Pointers for a Successful Case

- 1. Take a field trip to the farm and get to know the history of the farming operation. Learn about the industry. Talk to the accountant, the appraiser, and any other professionals involved. Why is the Debtor in the situation it is in? How can bankruptcy help?
- 2. Review last three (3) years of tax returns, including all schedules.
  - I. Inquire as to status/whereabouts of all assets listed on depreciation schedules.
  - II. Review Profit and Loss statements filed with returns, inquire as to what has or will change.
- 3. Obtain valuations prior to filing, use this information in negotiating with creditors prior to filing.
- 4. Obtain a lien search on all real and personal property.
- 5. Review all loan and lien documents and reach out to the main creditors prior to filing. Chapter 12 is much more akin to Chapter 11 in terms of needing pre-filing communication and agreements.

## Chapter 12 Eligibility

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### A. Who/What may be a debtor under Chapter 12?

1. In order to be eligible to file Chapter 12, a debtor must be a “family farmer or a family fisherman with regular income.” 11 U.S.C. § 109(f).

**109(f)** Only a family farmer or family fisherman with regular annual income may be a debtor under chapter 12 of this title.

2. To qualify as either a “family farmer” or a “family fisherman” the debtor must meet multiple tests defined in 11 U.S.C. § 101(18) & (19A), respectively.

### B. Who/What qualifies as a “family farmer” for purposes of Chapter 12?

1. Can be an individual, individual and spouse, corporation, or partnership.
2. “Family Farmer” defined.

101(18) The term “family farmer” means—

(A) individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed \$10,000,000 and not less than 50 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for—

(i) the taxable year preceding; or  
(ii) each of the 2d and 3d taxable years preceding; the taxable year in which the case concerning such individual or such individual and spouse was filed; or

(B) corporation or partnership in which more than 50 percent of the outstanding stock or equity is held by one family, or by one family and the relatives of the members of such family, and such family or such relatives conduct the farming operation, and

(i) more than 80 percent of the value of its assets consists of assets related to the farming operation;

(ii) its aggregate debts do not exceed \$10,000,000 and not less than 50 percent of its aggregate non-contingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a farming operation), on the date the case is filed, arise out of the farming operation owned or operated by such corporation or such partnership; and

(iii) if such corporation issues stock, such stock is not publicly traded.

3. Easiest to evaluate eligibility in terms of a series of “tests” of eligibility based on the definition in the Code.

**C. Family Farmer: The Total Debt Test (applies to individuals, corporations, and partnerships)**

1. The debts must be under certain debt limitations. The aggregate debts must not exceed \$10,000,000.00.<sup>1</sup>
2. “Aggregate” – total of all debt.
3. Includes unliquidated and contingent debts.
4. Contrast with Chapter 13 eligibility which does not include unliquidated and contingent debts for purposes of eligibility.

**109(e)** Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than \$419,275 and noncontingent, liquidated, secured debts of less than \$1,257,850, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than \$419,275<sup>(1)</sup> and noncontingent, liquidated, secured debts of less than \$1,257,850 <sup>(2)</sup> may be a debtor under chapter 13 of this title.

5. Include “disputed” debts?
  - a. Yes. *In re Vaughan*, 100 B.R. 423, 424–25 (Bankr. S.D. Ill. 1989)—“The ‘aggregate debt’ limitation applicable to Chapter 12 debtors is unique in that it, unlike other debt limitations under the Code, is unqualified and simple. . . . There is no exception under the statute for disputed debts, and the plain language of the statute indicates that such debts should be considered along with other types of debts in the threshold test . . . despite their disputed status” (internal citations omitted).
  - b. Or not? *See 2 Collier on Bankruptcy* ¶ 101.18 (Richard Levin & Henry J. Sommer eds., 16<sup>th</sup> ed.). If the validity of a debt is disputed, the court should make a preliminary determination with regard to the validity of the debt. If it is prima facie valid, it should be counted even though the debtor may have defenses to payment or rights of offset. *In re Cross Timbers Ranch*, 151 B.R. 923 (Bankr. W.D. Mo. 1993). In determining the amount of the debtor’s outstanding debts, the debtor’s schedules should be accorded prima facie

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<sup>1</sup> The dollar amounts included in sections 101(18) and 101(19A) (debt limits for family farmers and fishermen) adjust to reflect the change in the Consumer Price Index, rounded to the nearest \$25 amount. 11 U.S.C. § 104(a). *To be readjusted effective April 1, 2022. However, updated to \$10,000,000.00 per Family Farmer Relief Act, Pub. L. 116-51, effective 8/23/2019.*



validity. *In re Perkins*, 581 B.R. 822, 832 (B.A.P. 6th Cir. 2018) (“eligibility for Chapter 12 should normally be determined by the debtor’s schedules, checking only to see if the schedules were made in good faith”; concluding that debt limit eligibility is not jurisdictional).

6. Spouses. The spouse’s combined debts are considered for purposes of eligibility. *In re Johnson*, 73 B.R. 107, 108 (Bankr. S.D. Ohio 1987)—Spouses could not file separate Chapter 12 petitions to avoid exceeding the debt limits, as the point of Chapter 12 was to treat the “family farm as an economic unit worthy of special protection.”

**D. Family Farmer: The Farm Debt Test. (Applies to individuals, corporations, and partnerships)**

1. Not less than 50% of the aggregate noncontingent, liquidated debts must be from a “farming operation.”
2. Do not include “contingent” or “unliquidated” debts for this calculation. Generally, courts hold that a debt is noncontingent “so long as all the events giving rise to the debt occurred before the commencement of the bankruptcy case, and a debt is liquidated if it is susceptible to ready calculation.” *In re Haarmann*, 387 B.R. 216, 218 (Bankr. SD Ill 2008).
3. Farming Operation Related Residence Exception.
  - a. Principal residence debt. In the context of 11 U.S.C.S. § 101(18)(A), a debt “for” a principal residence “arises out of” a farming operation only if the debt was directly and substantially connected to the farming operation.
  - b. Direct and substantial connection. “In short, under the interpretation of the statutory phrase ‘arise out of’ that we articulate here—which contemplates a direct and substantial connection between the principal-residence debt and the farming operation—and under the test that is congruent with this statutory interpretation, the objective direct-use test, the bankruptcy court committed legal error. Specifically, it did so in concluding that two attributes of Debtors’ principal residence—(1) that it contains an office and the farming operation’s books and records, and (2) that it is located in proximity to the farming operation—were legally sufficient to classify debt that was incurred for the principal residence as debt that arose out of a farming operation.” *First Nat’l Bank v. Woods (In re Woods)*, 743 F.3d 689, 707 (10<sup>th</sup> Cir. 2014).
  - c. Purpose of debt. It is the *purpose* of the debt which determines whether it arises out of a farm operation. *Acee v. Oneida Sav. Bank*, 529 B.R. 494, 498 (N.D.N.Y. 2015).

4. Debts Arising out of Marital Dissolution. Courts are also split over whether payments under a divorce decree should be considered arising from the farming operation for purposes of the debt limits. *See, Matter of Marlatt*, 116 B.R. 703 (Bankr. D. Neb. 1990) (holding that \$130,000 debt owed to wife in divorce decree was related to the farming operation). *But see, In re Van Fossan*, 82 B.R. 77 (Bankr. W.D. Ark. 1987) (holding that the \$295,000 debt to former spouse had not arisen from the farming operation).

#### **E. Family Farmer: The Regular annual income Test.**

1. The definition.

**101(19)** The term “family farmer with regular annual income” means family farmer whose annual income is sufficiently stable and regular to enable such family farmer to make payments under a plan under chapter 12 of this title.

2. Applies to Individuals, corporations, and partnership)
3. Does not have to be farm income!

#### **F. Family Farmer: The Income Test – (for individuals only; not required for corporations or partnerships)**

1. For an individual debtor to qualify as a family farmer, the individual must receive more than 50% of his gross income from a “farming operation.”
2. This income test only applies to individual family farmers, not corporate or partnership farmers.
3. The test looks to the debtor’s past performance. The Code provides that for an individual to qualify as a family farmer, “such individual [must] . . . receive from such farming operation more than 50 percent of such individual’s . . . gross income . . . for—(i) the taxable year preceding; or (ii) each of the 2d and 3d taxable years preceding the taxable year in which the case concerning such individual . . . was filed....”
4. Impact of Tax Code definition of Gross Income. *In re Sandifer*, 448 B.R. 382, 385–86 (Bankr. D. S.C. 2011)—“all income from whatever source derived”—and includes the income of an S Corporation rather than just the profits. the Tax Code may inform the Bankruptcy Code's definition of "gross income," but only to the extent that strict adherence to the Tax Code's definition would not unreasonably hinder the purposes of *chapter 12*.
5. Social security. Social Security income is only included in "gross income" to the extent provided by the Tax Code. *In re Rosenberger*, 2020 Bankr. LEXIS 2580, \*6-

7, 2020 WL 6940926 (Bankr. W.D. Va. Sept. 29, 2020); *Fuentes v. Danielson (In re Fuentes)*, Case No. 5:10-cv-01419-DDP, 2011 U.S. Dist. LEXIS 145178, 2011 WL 6294489, at \*2 (C.D. Cal. Dec. 16, 2011).

**G. Family Farmer: The Farming Operation Test (applies to Individuals, Partnerships and Corporations)**

1. Must be “engaged” in a “farming operation.”
2. When engaged in farming?
  - a. Date of Filing. The fact that Ms. DeGutis has bred horses and dogs in the past and has "reserved" a dog and intends to begin breeding dogs again (the breeding of animals including dogs has been found by courts to constitute a farming operation) does not change the result. *In re Degutis*, 2020 Bankr. LEXIS 3578, \*1-2 (Bankr. D. Mass. Dec. 23, 2020). The test for eligibility is determined at the time the case is filed. *In re Clark*, 288 B.R. 237, 246 (Bankr. D. Kan. 2003). The debtor need only be "engaged in" a farming operation when she filed her bankruptcy petition. *Id.* at 246-47; *In re Nelson*, 291 B.R. 861, 867-68 (Bankr. D. Idaho 2003); *In re Lockard*, 234 B.R. 484, 491 (Bankr. W.D. Mo. 1999). *In re Rosenberger*, 2020 Bankr. LEXIS 2580, \*5, 2020 WL 6940926 (Bankr. W.D. Va. Sept. 29, 2020).
  - b. Liquidation of Farm. Judge Lloyd noted that Section 1222(a)(8) allows a farmer to liquidate in chapter 12. She said it would make “little sense” to bar the use of chapter 12 “simply because the debtors made a reasonable financial decision to end a nonprofitable farming operation.” Although Section 101(19) requires “stable and regular income” as a condition to relief in chapter 12, the judge mentioned how the statute does not require that payments under a plan be “farming generated. *In re Williams*, 15-11023 (Bankr. W.D. Ky. April 22, 2016).
  - c. Confirmation Date Not Relevant. Income as of petition date from farming operation makes debtor eligible; debtors did not become ineligible when as of confirmation date they were no longer operating dairy farm. *In re Nelson*, 291 B.R. 861 (Bankr. D. Idaho 2003).
3. What is a “farming operation.”
  - a. Definition.

<p><b>101(21)</b> The term “farming operation” includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.</p>
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- b. Tests. Courts have formulated at least two tests to ascertain what constitutes a "farming operation."
  - i. The minority view test focuses on two key factors: (a) the debtor's operations must be subject to cyclical risks such that drought or disease may result in the debtor's inability to pay creditors; and (b) the activity engaged in by the debtor must relate to the debtor's own farming operation and not the farming operations of others. *In re McNeal*, 848 F.2d 170, 171-72 (11th Cir. 1988); *See also In re Armstrong*, 812 F.2d 1024, 1027 (7th Cir. 1987) ("[F]armers are caught in a risk ridden enterprise.").
  - ii. The majority view test is based on the "totality of the circumstances." Courts using this test should analyze the totality of the circumstances involved in the debtor's operation keeping in mind the remedial purposes behind Chapter 12. *E.g., In re Sugar Pine Ranch*, 100 B.R. 28, (Bankr. D. Or. 1989). *See, In re Paul*, 83 B.R. 709, 712 (Bankr. D.N.D. 1988) ("The majority of courts to consider the question [of whether an activity constitutes a farming operation] have adopted this 'totality of the circumstances' test.").
- c. The totality of the circumstances approach for determining whether a particular operation is a "farming operation" considers the relevant facts case-by-case, with a view to seven common, but non-exclusive, factors:
  - i. Whether the location of the operation would be considered a traditional farm;
  - ii. The nature of the enterprise at the location;
  - iii. The type of product and its eventual market...;
  - iv. The physical presence or absence of family members on the farm;
  - v. Ownership of traditional farm assets;
  - vi. Whether the debtor is involved in the process of growing or developing crops or livestock; and
  - vii. [W]hether or not the practice or operation is subject to the inherent risks of farming.  
*In re Rosenberger*, 2020 Bankr. LEXIS 2580, \*6-7, 2020 WL 6940926 (Bankr. W.D. Va. Sept. 29, 2020) (citing *In re Osborne*, 323 B.R. 489, 494 (Bankr. D. Or. 005) (quoting *In re Sugar Pine Ranch*, 100 B.R. 28, 31 (Bankr. D. Or. 1989))).
- d. Examples that are not farming operations:
  - i. Crop dusting service. *In re Van Air Flying Service, Inc.*, 146 B.R. 816 (Bankr. E.D. Ark. 1992).
  - ii. Citrus harvesting service. *In re Blackwelder Harvesting Co., Inc.*, 106 B.R. 301 (Bankr. M.D. Fla. 1989).

- iii. Horse breeding, *In re Cluck*, 101 B.R. 691 (Bankr. E.D. Okla. 1989).
- e. Examples that are farming operations:
  - i. Income from sale of farm equipment and property. *In re Barnett*, 162 B.R. 535 (Bankr. W.D. Mo. 1993).
  - ii. Renting equipment and property. *In re Creviston*, 157 B.R. 380 (Bankr. S.D. Ohio 1993).
  - iii. Income from hauling of third parties' cattle when it was tied to efficiency of debtors' ranching operations. *In re Guinnane*, 73 B.R. 129 (Bankr. D. Mont. 1987).
  - iv. Feeding and maintaining other people's cattle. *In re Maike*, 77 B.R. 832 (Bankr. D. Kan. 1987).
  - v. Boarding horses. *In re Hoel*, 617 B.R. 636, 639-640 (Bankr. W.D. Wis. 2020); *But see, In re Poe* 2009 Bankr. LEXIS 2068, 2009 WL 2357160, at \*3-5 (Bankr. N.D.W. Va. July 29, 2009), for a discussion of the "mixed" caselaw on the issue of boarding horses.

#### **H. The Asset Test (applies to corporations and partnerships only)**

- 1. Test only applies to non-individual farmers.
- 2. 80% of the asset value must be from assets related to the "farming operation."

#### **I. The Ownership Test (applies to corporations and partnerships only)**

- 1. The non-individual debtor must be a business entity in which "more than 50 percent of the outstanding stock or equity is held by one family, or by one family and the relatives of the members of such family, and such family or such relatives conduct the farming operation.
- 2. Equity of the entity is not publicly traded.
- 3. Good Faith.
  - a. Good faith required in Chapter 12 filing. 11 U.S.C. § 1225(a)(3).
  - b. An individual debtor who would not meet the gross income source requirements under section 101(18)(A) may incorporate to avoid that

requirement and not violate the “good faith” filing requirement. *In re McSwine Creed Farms, Inc.*, 276 B.R. 461 (Bankr. N.D. Miss. 2000).

## **J. Who/what qualifies as a “family fisherman” for purposes of Chapter 12?**

### **1. Definition.**

(19A) The term “family fisherman” means—

(A) an individual or individual and spouse engaged in a commercial fishing operation—

(i) whose aggregate debts do not exceed \$2,044,225(\*) and not less than 80 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse, unless such debt arises out of a commercial fishing operation), on the date the case is filed, arise out of a commercial fishing operation owned or operated by such individual or such individual and spouse; and

(ii) who receive from such commercial fishing operation more than 50 percent of such individual’s or such individual’s and spouse’s gross income for the taxable year preceding the taxable year in which the case concerning such individual or such individual and spouse was filed; or

(B) a corporation or partnership—

(i) in which more than 50 percent of the outstanding stock or equity is held by—

(I) 1 family that conducts the commercial fishing operation; or

(II) 1 family and the relatives of the members of such family, and such family or such relatives conduct the commercial fishing operation; and

(ii)

(I) more than 80 percent of the value of its assets consists of assets related to the commercial fishing operation;

(II) its aggregate debts do not exceed \$2,044,225(\*) and not less than 80 percent of its aggregate noncontingent, liquidated debts (excluding a debt for 1 dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a commercial fishing operation), on the date the case is filed, arise out of a commercial fishing operation owned or operated by such corporation or such partnership; and

(III) if such corporation issues stock, such stock is not publicly traded.

(\*)As adjusted under section 104, effective April 1, 2019. To be readjusted effective April 1, 2022.

### **2. Can be an individual, individual and spouse, a corporation or partnership.**

### **3. A “family fisherman” is:**

#### **a. An individual or an individual and spouse engaged in a commercial fishing operation—**

i. “whose aggregate debts do not exceed \$2,044,225 and not less than 80 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual . . . unless such debt arises out of a commercial fishing operation), on the date the case is filed, arise out of a commercial fishing operation owned or operated by such individual” and

ii. “who receive from such commercial fishing operation more than 50 percent of such individual’s or such individual’s . . . gross income for the taxable year preceding the taxable year in which the case concerning such individual or such individual . . . was filed” or

#### **b. A business entity—**

i. in which more than 50 percent of the outstanding equity is held by—

- one family that conducts the operation or
  - relatives of that family, and
- ii. more than 80 percent of the value of the assets are related to the fishing operation;
  - iii. its aggregate debts are less than \$2,044,225 and not less than 80 percent of the aggregate noncontingent, liquidated debts (excluding one dwelling used as such by an equity holder as principal residence, unless it arises from the operation), on the date of the case, arise out of a commercial fishing operation operated by such a business entity; and
  - iv. equity interests in the entity are not publicly traded.

4. Must be both a “family fisherman” and have “regular income.”

- a. “Family fisherman with regular annual income” is one “whose annual income is sufficiently stable and regular to enable such family fisherman to make payments under a plan under chapter 12 of this title.” 11 U.S.C. § 101(19B).
- b. Aquaculture Activities. Raising for market any species of fish, shrimp, lobsters, urchins, seaweed, shellfish, or other aquatic species or products of such species. *Lakefront Investors LLC v. Clarkson*, 484 B.R. 72, 74–75 (D. Md. 2012).
- c. No Ownership. Debtors also had not shown that they owned or operated a commercial fishing concern. Schedules G and F indicated that debtor was a seasonal employee of a commercial fishing operation, and debtors did not list an ownership or management interest in any commercial fishing operation. *In re Allen*, 2012 Bankr. LEXIS 1747, \*1.
- d. Need Regular Income. Debtor did not have the required regular annual income to meet the definitional requirement of either § 101(19B) or § 109(f) for relief as a family fisherman under Chapter 12 because, since debtor filed for bankruptcy relief, it had had no operating income whatsoever, and its only source of income was from loans. *In re Victorious, LLC*, 545 B.R. 815, 817 (Bankr. D. Vt. 2016).

## Chapter 12—Diving into the Feasibility Weeds

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Except as provided in subsection (b), the court shall confirm a plan if—  
the debtor will be able to make all payments under the plan and to  
comply with the plan...

11 U.S.C. § 1226(a)(6)

If Chapter 12 had its own version of Urban Dictionary, feasibility may be defined as “will the trustee and creditors be able to cash the checks the debtor is going to write?” From a broad perspective, the concept of feasibility is very similar between Chapter 12 and Chapter 13. See 11 U.S.C. § 1325(a)(6). Chapter 13 is probably a little easier to analyze as a significant majority of Chapter 13 debtors are wage earners and thus projecting their income is as simple as an analysis of their current pay advices. If a Chapter 13 debtor will only earn \$1,000.00 per month, then a \$1,500.00 monthly Plan payment is simply not feasible.

Feasibility in Chapter 12 is often more complex because a farmer does not necessarily earn a regularly recurring paycheck. Quantifying a farmer’s source of income over the next several years is difficult because it will necessarily be impacted not only by market forces but also natural forces. Furthermore, if you have not yet had the pleasure of representing a farmer, they tend to be a breed of people who truly and sincerely believe that a handshake is as good as, if not better than, a signed contract. Making income projections from leased farmland, for example, difficult to document when the lease has been memorialized by a handshake. Given these considerations, a general requirement for a Chapter 12 Plan’s feasibility merely requires “reasonable assurance of success” and need “not...guarantee success.” *In re Perkins*, 581 B.R. 822, 841 (B.A.P. 6<sup>th</sup> Cir. 2018). The analysis for whether a Plan has a reasonable assurance of success “is not typically a simple yes-or-no question but rather an analysis of where, on a continuum of feasibility, a particular plan falls.” *In re Simpson*, No. 17-10442, at \*3 (Bankr. D. Vt. June 1, 2020). The *Simpson* court stated that in the middle of the continuum, feasibility is not based on “a mathematical computation of fixed components,” but “a judgment based on an assessment of myriad moving and mutable parts.” *Id.*

In *Perkins*, the debtor projected significant increases in crop yields but demonstrated this was possible because an additional 240 acres was planted since the last season, the crop insurance documents demonstrated the debtor’s farm produced about 25% more than the average farm in its county, and the year prior to the filing weather events prevented a successful wheat crop. *In re Perkins*, 582 B.R. at 840. Additionally, the court found that while land leases were an oral agreement which may be problematic under the state’s statute of frauds, the court stated enforcement of leases longer than a year were problematic and the debtor’s lease agreements were exactly one year. Further, the court found the longstanding relationship between the debtor and the lessees indicated likelihood the lease income would continue. *In re Perkins*, 582 B.R. at 841. Thus, the court concluded the debtor presented a reasonable assurance of success.



The burden of proof to establish feasibility rests upon the debtor as the proponent of the Plan. *In re Pressley*, 502 B.R. 196, 202 (Bankr. D.S.C. 2013). Thus, it is up to the debtor to establish “reasonable assurance” and the inquiry will necessarily be fact based. *In re Ellis*, 478 B.R. 132, 139 (Bankr. N.D.N.Y. 2012). As previously stated, producing evidence upon which to base a farmer’s testimony is often difficult because, while a debtor-farmer may be able to grow 50 bushels of wheat on a rock, his or her inability to produce the crop insurance binder, the written lease for the rock, and the financial documents to demonstrate the expenses for that crop may place the Plan on the wrong end of the feasibility continuum. In *Ellis*, the court found the debtor to be straightforward, well-intentioned, and intent on saving a family farm. 478 B.R. at 139. However, the debtor’s inability to produce evidence of historical crop production, a business plan for what would be a new retail venture, any documentation to support the debtor’s projected compensation for a neighbor’s unauthorized use of her water for irrigating his crops, and any current documentation to support the proposed sale of real estate resulted in the court finding the Plan infeasible. *In re Ellis*, 478 B.R. at 139.

Expert witnesses often play a significant role in directing a court through a feasibility analysis. Note also, while not an expert, a debtor is often a possible witness to explain his or her own financials. However, be sure the witness is familiar with all aspects of farming operations, including the debtor’s operation. In *Simpson*, the debtor and its witnesses persuaded the court more than the creditor’s accountant who was not experienced in the debtor’s operation and thus the court confirmed the plan. *In re Simpson*, No. 17-10442, at \*4. Experts need to review not only the current projections, but also the operation’s historical performance with an explanation of how future projections are possible. In *In re Akers*, a farming expert corroborated the future projections, but his testimony ultimately found unpersuasive where the expert did not analyze or consider the operation’s prior years. *In re Akers*, No. 20-70297 (Bankr. W.D. Va. 2020).

Practically speaking, a roadmap for feasibility should include the following points:

- 1) What are the crops or products?
  - a. If the crops are the same as historically produced by the operation, make sure revenues are verifiable in documents. Compare gross income in prior tax returns. Of this what did each crop generate and what factors for the future indicate projected increases or decreases. There are websites that will provide reports for average yields broken down by state and counties. See for example, [https://www.nass.usda.gov/Statistics\\_by\\_State/Virginia/index.php](https://www.nass.usda.gov/Statistics_by_State/Virginia/index.php). These websites are often difficult to use so you may need to obtain the farmer’s assistance to obtain data. You may also be able to obtain help from the local Farm Service Agency to obtain resources for projections. <https://www.fsa.usda.gov/state-offices/Virginia/index>
  - b. Farmers are becoming resilient and changing crops and operations altogether. However, if the farmer does not have historical data for the new operation’s yields, you will need the assistance of an expert to be able to explain projections. If any expenses will be incurred to facilitate the change, these will need to be quantified with an explanation how the expenses will be funded.
- 2) What will be the costs of production?

- a. The costs of production are admittedly difficult to generate if the farmer brings a shoebox of receipts to explain the operation's finances. This often makes feasibility analysis the most difficult, especially when the farmer says the accounting system has been updated and the system has been moved from a shoebox to a Tupperware container.
- b. Tax returns are often a good starting point, but the expenses will need to be probed. All expenses may not have been reported. Expenses may have been incurred one year because of a weather event that may not happen again in the next few years. If the operation will scale up or down, expenses should scale proportionally.
- c. Again, the same websites that provide historic and projected yields often provide average expenses for a crop's yield and this certainly could be a resource. One resource is <https://www.ers.usda.gov/data-products/commodity-costs-and-returns/commodity-costs-and-returns/#Cost-of-Production%20Forecasts>.

Chapter 12  
*Issues for Creditors in a Chapter 12 Bankruptcy*

By

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I. Adequate Protection

- A. A secured creditor is entitled to “adequate protection” against the decline in value of its collateral during the pendency of a Chapter 12 bankruptcy. This protection can take the form of any of the following:
1. Cash payment - single or periodic to match the decrease in the value of the collateral - 11 U.S.C. §1205(b)(1);
  2. Replacement of lien(s) - providing additional collateral §1205(b)(2);
  3. Reasonable rent - rent in amounts customary in the community for comparable real estate (taking net income and earning capacity of the property into account) - 11 U.S.C. §1205(b)(3); or
  4. Equity cushion - Equity in the collateral can be its own adequate protection - 11 U.S.C. §1205(b)(4).

*Practice Note: Because of the risks associated with farming, a lien on crops to be grown in the future may not be adequate protection for the use of cash collateral. In Re Walker, 2011 Bankr. LEXIS 690 (Bankr. C.D. Ill.) However, a replacement lien plus assignment of crop insurance proceeds, assignment of government payments and providing a priority administrative expense claim for any shortfall, was deemed to be adequate protection in In Re Blake, 2017 Bankr. WL 1906603 (Bankr. S.D. Ill.)*

- B. The issue of adequate protection is raised either by a motion filed by the debtor with the Petition or as agreed to by the secured creditor(s) (preferably before the Petition is filed).
- C. If contested, the burden of proof is on the debtor to demonstrate adequate protection.

II. Cash Collateral

- A. 11 U.S.C. §363 (a) defines cash collateral as “cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents...in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents or profits of property ...”

- B. 11 U.S.C. §363(c)(2) - A debtor (in possession) may not use, sell or lease cash collateral unless the secured creditor consents or the Court authorizes its use, sale or lease after notice and a hearing.
- C. 11 U.S.C. §363(e) requires a debtor to provide adequate protection of the secured creditor's interest before he can use cash collateral.

### III. Other Triggers for Adequate Protection

- A. Creditor requests relief from automatic stay
- B. Debtor proposes to use, sell or lease property
- C. Debtor proposes to borrow money or incur credit to be secured by a lien

### IV. Challenges Associated with Agricultural Collateral

- A. Fluctuating commodity and livestock markets
- B. Vulnerable/perishable collateral
- C. Mobility of collateral
- D. Expenses subject to market fluctuations (fuel, fertilizer, feed, etc.)
- E. Weather

Because of the uncertainty associated with agricultural collateral, most courts do not require a debtor to prove that a plan's success is guaranteed. To meet the feasibility standard in a Chapter 12, a court will require proof of a reasonable chance to succeed. However, they will want to see evidence of a history of actual farming performance and results and current condition of debtor's business. *In Re Terry Properties, LLC*, 569 B.R. 76 (Bankr. W.D. Va. 2017) citing *Keith's Tree Farms*, 519 B.R. 628, 637 (Bankr. W.D. Va. 2014)

#### Practice Points for Creditors

1. Conduct UCC and/or title search to verify lien position and existence of additional liens
2. Make sure your liens are properly perfected
3. Verify your collateral's existence, location and status on a regular basis

#### Practice Points for Debtors

- 1 Conduct title search for real property and UCC search for personal property to determine extent, priority and perfection of liens
- 2 Negotiate terms of use of cash collateral with secured creditors pre-petition
- 3 Maintain historical data of farm performance and prepare realistic budget

V. Post-Petition Farm Operations (11 U.S.C. §1203)

- A. Debtor in Possession - Although the term “debtor in possession” is not defined in Chapter 12, a “debtor shall remain in possession of all property of the estate.” 11 U.S.C. §1207(b)
- B. Removal of Debtor as “debtor in possession” - Following notice and a hearing, a debtor may be removed as a debtor in possession for cause, including “fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor.” 11 U.S.C. §1204(a)
- C. “Subject to such limitations as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330, and powers, and shall perform all the functions and duties, except the duties specified in paragraphs (3) and (4) of section 1106(a), of a trustee serving in a case under chapter 11, including operating the debtor’s farm or commercial fishing operation.”
  - 1. *In re Double J Cattle Co.*, 203 BR 484 (Bankr. DC Wyo 1995) --Chapter 12 debtor’s knowledge of lien’s existence did not preclude the debtor from avoiding an unperfected lien in its cattle under 11 USCS §544(a).
  - 2. *In re Eckberg*, 446 BR 909 (Bankr. CD Ill 2011) --Chapter 12 debtor had right to enter into post-petition grain contracts without notice or hearing because contracts were obligations undertaken in ordinary course of business.

VI. Exceptions to Discharge - A creditor can bring an adversary proceeding against a Chapter 12 debtor under 11 U.S.C. §523 to seek an exception to discharge.

- A. False pretenses, false representation or actual fraud §523(a)(2)
- B. Embezzlement 11 U.S.C. §523(a)(4)
- C. Willful and malicious injury 11 U.S.C. §523(a)(6)

*Practice Note for Creditors:*

*The vulnerable/perishable and mobile nature of some types of agricultural collateral can make it difficult to prove a debtor’s misrepresentation with respect to such collateral.*

VII. Miscellaneous Notes for Creditors

- A. Only a debtor can file a petition under Chapter 12.
- B. A proof of claim must be filed by secured and unsecured creditors within ninety (90) days of the first date of the 341 meeting of creditors. Fed. R. Bankr. P. 3002(c)

- C. If a secured creditor has a lien on debtor's primary residence, a proof of claim must be filed no later than 70 days after the order for relief is entered. Fed. R. Bankr. P. 3002(c)(7)(A)
- D. Creditors cannot file their own plan in a Chapter 12.
- E. There are no creditor committees in a Chapter 12 bankruptcy, and creditors do not vote to accept or reject a Chapter 12 plan. However, a creditor can object to confirmation if the plan does not satisfy the statutory requirements. 11 U.S.C. §1225
- F. Secured creditors' secured claims are subject to being written down to equal the value of the collateral. 11 U.S.C. §1222(b)(2) They can file a proof of claim for the unsecured portion of their debt.
- G. A Chapter 12 debtor has the absolute right to surrender to a secured creditor all of its collateral in satisfaction of the secured claim. 11 U.S.C. §1225(a)(5)(B) or (C)

## Chapter 12—Unique Tax Issues

### I. Capital gains

1. When you sell an asset the difference between the adjusted basis in the asset and the amount realized is the gain or loss. Topic No. 409 Capital Gains and Losses, <https://www.irs.gov/taxtopics/tc409> (last visited Feb. 25, 2021).
2. In Chapter 12, gains can be significant if asset is a 600 acre farm purchased for \$1,000.00 per acre and is now being sold for \$2,000.00 per acre.
3. Before Congressional action, if the asset was sold prepetition it may be subject to priority status and must be paid in full. If sold post-petition it was not part of the Chapter 12 estate and would still have to be paid in full. Either way, the liability could prohibit a successful plan for any farmer.

### II. Congressional action

1. Congress passed 11 U.S.C. § 1222(a)(2) which de-prioritized the capital gain tax, however, the Supreme Court ruled the new tax provision applied only to pre-petition liabilities leaving any post-petition sale due and payable in full.
2. ***Hall v. United States*, 132 S. Ct. 1882 (2012)**—“[T]he federal income tax liability resulting from petitioners’ postpetition farm sale is not ‘incurred by the estate’ under § 503(b) and thus is neither collectible nor dischargeable in the Chapter 12 plan.” The ruling turns on the fact that a Chapter 12<sup>1</sup> bankruptcy estate is not a taxable entity under the terms of the Bankruptcy and Tax Codes, and, thus, the postpetition income derived therefrom is taxable only as to the debtor. *Id.* at 1889.
3. Congress responded to *Hall* by enacting 11 U.S.C. § 1232 which now specifically de-prioritizes **pre and post-petition taxes** from “the sale, transfer, exchange or other disposition of property.”
  1. The claim must be paid at least what it would be paid if the case were liquidated under Chapter 7. 11 U.S.C. § 1232(b). This may be problematic if the sale occurs in the fifth year of a Chapter 12 Plan.
  2. The debtor is required to serve notice on the governmental units impacted of any tax arising post-petition. 11 U.S.C. § 1232(d)(2).

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<sup>1</sup> The Supreme Court reaches this conclusion by relying on Chapter 13 caselaw, citing 8 Collier ¶1200.01[5], at 1200–10; *In re Lopez*, 372 B.R. 40, 45 n.13 (B.A.P. 9th Cir. 2007); *Justice v. Valley Nat’l Bank*, 849 F.2d 1078, 1083 (8th Cir. 1988). *Id.* at 1889.

### III. Other Special Tax Provisions (11 U.S.C. § 1231)

1. (a) “The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1225 of this title, may not be taxed under any law imposing a stamp tax or similar tax.”
2. (b) “The court may authorize the proponent of a plan to request a determination, limited to questions of law, by any governmental unit charged with responsibility for collection or determination of a tax on or measured by income of the tax effects, under section 346 of this title and under the law of imposing such tax, of the plan. In the event of an actual controversy, the court may declare such effects after the earlier of—
  1. (1) the date on which such governmental unit responds to the request under this subsection; or
  2. (2) 270 days after such request.”

IV. Practice note: Tax implications are horrifically complicated. To avoid malpractice claims, utilize the assistance of an experienced tax professional.